No. 15552

IN THE

# United States Court of Appeals

FOR THE NINTH CIRCUIT

---

First Western Savings and Loan Association and Silver State Savings and Loan Association,

*Appellants,*

*vs.*

Mae Anderson, Trustee of the Estate of Rose Holding Corporation, and Gordon L. Hawkins,

*Appellees.*

---

## APPELLANTS' REPLY BRIEF.

---

Samuel S. Lionel,
300 Fremont Street,
Las Vegas, Nevada,
*Attorney for Appellants.*



Parker & Son, Inc., Law Printers, Los Angeles. Phone MA. 6-9171.

## TOPICAL INDEX

## TABLE OF AUTHORITIES CITED

### Cases



### Statutes



### Textbook

No. 15552

IN THE

# United States Court of Appeals

FOR THE NINTH CIRCUIT

---

First Western Savings and Loan Association and Silver State Savings and Loan Assocition,

*Appellants,*

*vs.*

Mae Anderson, Trustee of the Estate of Rose Holding Corporation, and Gordon L. Hawkins,

*Appellees.*

---

## APPELLANTS' REPLY BRIEF.

---

### ARGUMENT.

**Section 246 of the Bankruptcy Act Did Not Authorize the Court Below to Make Allowances of the Trustee and Her Attorney First Liens on Property Subject to Appellants' Deeds of Trust.**

Appellees argue that Section 246 of the Bankruptcy Act (11 U. S. C. A. 646) has changed the rule that prevailed prior to 1938.

There is nothing contained in Section 246 which authorized the action taken by the District Court. While the section authorized the Court to make provisions for payment of reasonable allowances for services, it did not authorize such allowances to be made prior liens.

Surely if the section was intended to change the law in the drastic manner contended by Appellees there would be some language specifically doing so, particularly in view of the numerous pre-1938 decisions holding that mortgage security could not be impaired to pay administration expenses prior to approval of a plan of reorganization, *i.e., Duparquet Co. v. Evans,* 297 U. S. 216, 222, 223, 80 L. Ed. 591, 595; *In re Forty-one Thirty-six Wilcox Bldg. Corp.* (7 Cir.), 100 F. 2d 588, 595; *Louisville Title Mortgage Company v. Louisville Storage Company* (6 Cir.), 93 F. 2d 1008, affirming *In re Louisville Storage Company,* 21 Fed. Supp. 897; *Oakland Hotel Co. v. Crocker First National Bank of San Francisco* (9 Cir.), 85 F. 2d 959, 961. And see 8 C. J. S., *Bankruptcy,* Sec. 872.

It is noteworthy that the Commentary on the Chandler Act by former United States District Judge George E. Q. Johnson, the author of Johnson's Bankruptcy Reorganizations, contained at the beginning of 11 U. S. C. A., Secs. 501 to end, in the discussion of "Compensation and Allowances," says nothing about making administrative expenses of an abortive reorganization proceeding a prior lien on secured property of the debtor. Instead, the author states that under the Chandler Act compensation is allowed more extensively than under the old law and the decisions limiting such allowances. Manifestly, if Judge Johnson had any reason to believe that Section 246 had the effect of changing the law as enunciated in the cases above cited, he would have so commented.

In the case of *In re Freeport Standard Dairy Corporation,* 124 F. 2d 783, 784, a 1941 case, quoted on page 7 of Appellants' Opening Brief, the Seventh Circuit said that *Duparquet v. Evans,* 297 U. S. 216, 80 L. Ed. 591, left no doubt that a mortgage lien could not be impaired before

approval of a final plan of reorganization, and the Chandler Act did not change the rule.

In 1946, the same Court, in the case of *In re Sheridan View Bldg. Corporation,* 154 F. 2d 1008, 1009, reviewed the authorities and held it was without power to award fees or expenses except when incurred in connection with the formation of a plan of reorganization. That Court said that "Indeed we think this is generally accepted law."

The contention of the Appellees was apparently made in the case of *In re Centralia Refining Co.* (D. C. Ill.), 35 Fed. Supp. 599, 601, 602, quoted on page 9 of Appellants' Opening Brief. The Court there said that Section 246 had to be read together with Section 238 of the Bankruptcy Act (11 U. S. C. A. 638):*

> "Reading sections 238 and 246 together it would appear that the provision which the court is required to make for the payment of costs and expenses incurred in the unsuccessful corporate reorganization proceeding must be governed by the principles which control the provision for the payment of costs and expenses of administration in regular bankruptcy proceedings."

The *Centralia* case was cited approvingly by the Second Circuit in 1941 in the case of *In re Franklin Garden Apartments,* 124 F. 2d 451, 454. In that case, the Court

---

*Section 238 pertinently provides as follows:

"Upon the entry of an order directing that bankruptcy be proceeded with—

"(1) . . . where the petition was filed under section 528 of this title, the proceeding shall thereafter be conducted so far as possible, in the same manner and with like effect as if an involuntary petition for adjudication has been filed at the time when the petition under this chapter was filed, and a decree of adjudication had been entered at the time when the petition under this chapter was approved."

reversed an order which authorized the use of sixteen thousand dollars out of the rentals of the debtor's property covered by a mortgage to install a sprinkling system on the property. The Court, consisting of Justices Augustus Hand, Learned Hand and Clark, said as follows:

> "We can see no equity, fairness or adequate protection of the mortgagee's rights in diverting rentals derived from the property covered by his mortgage (which became due in October, 1941) in order to build up an illusive equity. This is particularly the case where it is not certain that there will be any plan approved and that the mortgaged premises may not be sold in bankruptcy pursuant to Section 236, 11 U. S. C. A. §636, or the proceeding under Chapter X may not be dismissed.
>
> "We think that the rentals may be used to pay current operating expenses of administration. While such expenses may hereafter be paid from rentals or other sources by virtue of Sections 241, 246 or 259 of the Chandler Act, 11 U. S. C. A. §§641, 646, 659, there seems no justification for allowing them at the present time, or indeed for allowing them at any time, out of the security belonging to the mortgagee, except insofar as the mortgaged property has received benefit through the proceeding (Randolph v. Scruggs, 190 U. S. 533, 23 S. Ct. 710, 47 L. Ed. 1165; In re Centralia Refining Co., D. C. Ill., 35 F. Supp. 599, 602), or the mortgagee's rights are fully secured."

Appellees cite three cases as authority for its position: *Matter of Riddlesburg Mining, Inc., Debtor,* 224 F. 2d 834; *In re Chapman Coal Co.,* 196 F. 2d 779; and *In re Rice Leghorn Farm, Inc.,* 113 Fed. Supp. 903.

The *Chapman* case does not aid the Appellees, but instead supports the position of the Appellants. In that

case the appellant had liens on all the property of the debtor. The District Court entered an order permitting the debtor to continue operation of its mine and made the payment of wages and union welfare fund contributions a first and prior lien upon assets of the debtor. On appeal the Seventh Circuit said that the record on appeal did not contain a proper transcript of the hearing at which the Court below had entered its order continuing the debtor's operation of the mine and as the appellant had a lien on all the assets of the debtor, the Circuit Court was required to assume that the appellant had agreed to the entry of the order continuing the operation of the mine, otherwise the District Court would not have entered the order.

The clear implication of the decision is that if the appellant mortgagee had objected to the continuance of the debtor in possession, the Court would have been without power to make the wage and welfare payments a first and prior lien upon assets covered by appellant's mortgagees.

Appellants are also unable to perceive the reason for the citation of the *Rice Leghorn Farm* case by the Appellees. That case cites approvingly *In re Sheridan View Bldg. Corporation, supra,* and *In re Louisville Storage Company, supra,* and even though the secured creditor there approved an order made at its instance, directing the dismissal of the reorganization proceeding, which order recited that the trustee was to pay compensation for services rendered in the proceeding as may be fixed by the Court out of all funds then in or were to come into his hands, and the balance remaining was to constitute a first lien on the secured property, the Court nevertheless limited the allowances to the funds in the hands of the trustee.

The fees allowed by the Court in *Rice Leghorn Farm* were five thousand dollars each to the trustee and the

attorney for the trustee even though the value of the debtor's assets were in excess of four hundred thousand dollars and the trustee and his attorney "rendered invaluable service in a proceeding which was of tremendous benefit, according to the undisputed testimony, to the secured creditor." There the trustee took obsolete assets and operated the going concern at a profit and for the benefit of the secured creditor. Obviously then, there is no similarity between that case and the case at bar. If anything, it supports the contentions of the Appellants.

*In re Riddlesburg Mining Company, supra,* is the only case cited by Appellees which appears to support their position. However, Appellants believe that an examination of the decision therein will clearly indicate that it should not be entitled to any weight by this Court.

The sole reason given by the Fifth Circuit for its view is set forth in one short paragraph, which paragraph, except for the citation to Section 246, is set forth on page 3 of Appellees' Answering Brief. The reason given by the Court is solely Section 246. No other authority of any kind is cited. The Court did not consider any pre-1938 cases, nor did it consider any later cases. Surely such a holding can hardly be considered persuasive, particularly in view of the apparently unanimous holdings *contra* in the other circuits.*

---

*One possible reason for the brief holding in the case is the fact that the District Court had dismissed the reorganization proceeding, adjudicated the debtor a bankrupt, and retained jurisdiction over the debtor's property for the purpose of paying administration expenses incurred. There was no order making administration expenses a prior lien, and while the issue was raised on appeal, it was probably not strongly urged, because the Court, in the decision, reversed an order of the District Court disallowing interest on a second mortgage from the date of the petition on the ground that the allowance of interest was premature. It would therefore appear that there existed ample security to pay the mortgage debt.

In the *Riddlesburg* case, the Court sustained the finding of the lower court that the petition, which was filed by creditors, was filed in good faith.

In the instant case, the petition was filed by the debtor and approved *ex parte* on the same day. The debtor became the owner of the property the day before, and it was scheduled to be sold the day after the petition was filed.

A petition is not filed in good faith if "it is unreasonable to expect that a plan of reorganization can be effected" (11 U. S. C. A. 545), or for the purpose of hindering creditors (*Provident Mutual Life Ins. Co. v. University Church* (9 Cir.), 90 F. 2d 992; *White v. Penelas Mining Co.* (9 Cir.), 105 F. 2d 726), or property is acquired for purposes of filing a petition (*In re Francfair, Inc.,* 13 Fed. Supp. 513; *In re Hudson Coal Co., 22* Fed. Supp. 768).

The good faith required at the inception of a reorganization proceeding must continue throughout (*In re Dutch Woodcraft Shops,* 14 Fed. Supp. 467) and whenever want of good faith appears, the proceedings should be terminated and the proceedings dismissed (*First National Bank of Wellston v. Conway Road Estates Co.,* 94 F. 2d 736; *Magidson v. Duggan,* 212 F. 2d 748).

During the entire proceeding, commencing with the first hearing the District Court repeatedly stated that there was no possibility of reorganization, and further stated that bad faith existed.

> "Court: I have an idea. My idea is—we might call it a doubt or fear that there will be difficulty in ever having a plan suggested." [Tr. Vol. II, p. 14, lines 5-7.]

"Court: . . . I don't see any in sight. How long has it been in Court?

Mr. Hawkins: A little over two months.

Court: And no one has come forward with any ideas for suggesting a plan?

Mr. Hawkins: Just the efforts of Mrs. Anderson.

Court: The trustee herself. But this creditor came into this Court. Why? If he came into this Court just to put his hand up and keep creditors away he will find he can't do that. It isn't to hold creditors at bay at all. It is just to hold them off long enough to give the corporation a chance to rehabilitate itself, if there is a possibility.

Mr. Hawkins: That was what the idea, the main idea of Mrs. Anderson was. That was the idea she had in attempting to put this thing in a position where it can be reorganized until the creditors—

Court: The Court is not inclined to lend itself and our assistance for that kind of thing. If the petitioners who petitioned this court, the debtor itself, came into this Court requesting the aid of this Court to give it an opportunity to organize, all right. The Court has gone that far. It has held everyone else in abeyance and also the efforts to satisfy claims of conveyance so that this can go on, but it is asking the Court a whole lot in asking its officers and the trustee or anyone else to reorganize the business. I wouldn't be inclined to grant the petition. If the debtor—if there is no possibility of reorganizing, then this ought to be adjudicated in bankruptcy as quickly as possible. There is a question of good faith in this thing. Here is a debtor who petitioned this Court and hasn't made a move, offered anything or made a suggestion or made any effort that the Court knows anything about to secure financial assistance." [Tr. Vol. II, p. 15, line 6, to p. 16, line 12.]

"Court: . . . I am inclined to think it was a mistake by anyone to feel that this corporation could be reorganized. I think—I doubt the good faith of the petition from what I have seen here. If I had known as much about it as I do now I would never have approved the petition for reorganization and put the thing back into bankruptcy, where I think it ought to go mighty quick. . . ." [Tr. Vol. II, p. 62, lines 5-11.]

"Court: Isn't it true there is no possibility of reorganizing or a Plan being submitted?" [Tr. Vol. II, p. 65, lines 19-20.]

It was obvious that the petition was filed in bad faith and for the sole purpose of hindering the Appellant Silver State Savings and Loan Association in realizing on its security. See *Oakland Hotel Co. v. Crocker First National Bank of San Francisco* (9 Cir.), 85 F. 2d 959, 961.

Appellees argue on pages 2 and 3 of their brief that *In re Centralia Refining Co.,* 35 Fed. Supp. 599, authorizes the lien, because the Court made a finding that the services of the trustee and her attorney were rendered for the preservation, protection and benefit of all the property of the debtor. Apparently the District Court felt that the case so held. [Tr. Vol. II, p. 166, lines 8-21.]

Appellants submit that the interpretation of Appellees and the Court below is not a proper one. In the *Centralia* case, the Court held that the costs of insurance, watchman, light and power were properly chargeable for the preservation of the secured property, but properly chargeable thereto. However, the Court very definitely held that fees of the trustee and attorney for trustee were not properly chargeable against the secured property.

And even assuming *arguendo* that the Appellees would be entitled to have their allowances charged to the property if their services were rendered for the preservation, protection and benefit of the property, except for the trustee hiring a merchant patrol for which she paid a total of $367.50 out of rentals received [Tr. Vol. II, p. 123, line 25; Vol. I, p. 102, line 2], there is no evidence to support any finding that their services were rendered for such purposes. The trustee devoted almost all her time to trying to sell the shopping center. [Tr. Vol. II, p. 149, line 22, to p. 150, line 8.] And see her Summary of Services Rendered. [Tr. Vol. I, p. 81, line 12, to p. 86, line 7.] The attorney for the trustee obviously did not render his services for such purpose. [See his Summary of Services Rendered, Tr. Vol. I, p. 89, line 14, to p. 93, line 17.]

Appellees' statement on page 4 of their brief that the second extension of time to present a plan was granted when it appeared likely that a plan could be effected is without basis in fact. Only one witness testified at that hearing, Lloyd H. Skrenes, a real estate salesman, who testified that there was some vague possibility of selling the shopping center, but there was no concrete proposal, nor did he have any idea what the price might be. [Tr. Vol. II, p. 89, line 22, to p. 97, line 1.]

As for the appraisal referred to on page 4 by the Appellees, it is submitted that replacement value bears little or no relationship to actual value. Appellants wish to point out to the Court that the replacement value of $124,000.00, referred to by Appellees, is in the record only because of a statement by the attorney for the trustee [Tr. Vol. II, p. 94, lines 16-23], and Appellants therefore respectfully take the liberty of advising

the Court that it was taken from an appraisal submitted by Appellant Silver State Savings and Loan Association as an exhibit to its motion to vacate the order approving the debtor's petition, and that the appraisal said the then current market value was only $89,000.00.

To use the words of this Honorable Court in *Oakland Hotel Co. v. Crocker First National Bank of San Francisco,* 85 F. 2d 959, 961, "The only result of this proceeding was to defer the prosecution of the foreclosure proceeding." Appellants submit that not only was that the result, but the record clearly demonstrates that it was the sole purpose of the proceeding.

Appellants respectfully submit that the order of the court below making the allowances a prior lien on the debtor's property be reversed.

Respectfully submitted,

SAMUEL S. LIONEL,

*Attorney for Appellants.*